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HAND DELIVERED

October 25, 2006

The Honorable Dennis P Hession
Mayor of Spokane

Re: Gasoline Prices
(Our Ref.: CCTN #79935)

Dear Mayor Hession:

I write to supplement my office's response to your written public records request of October 8, 2006. I have appreciated the opportunity to learn about your concerns regarding gasoline prices in Eastern Washington, in particular the difference you have observed between prices in your county and other parts of the state, especially the Seattle metropolitan area. This letter addresses those concerns, and supplements our response to your public records request which we provided to you by letter dated October 23, 2006.

First, my office and I share your concerns over the high price of gasoline generally, as well as price differentials between Spokane County and other areas of the state. We stand ready to do all within the power granted to us by statute and the Washington Constitution to vigorously pursue anyone who violates the law. All of us in the Attorney General's Office, including staff members in our Spokane office, are experiencing the same pinch on our household budgets as are the rest of our fellow Washingtonians. We have all built our lives to a great extent around the existing cost of energy and, when those costs rise quickly and substantially, they force us to make painful economic adjustments. Though at present gasoline prices are decreasing, the most recent run-up of prices to record levels has generated considerable public outcry and an understandable demand for an explanation of the causes of the increase as well as price differences between regions.

The starting point for any discussion of gasoline prices is to note that gasoline is an unregulated commodity at both the wholesale and the retail level. No government agency has the power to dictate what the oil companies, jobbers or local gas stations may charge for gasoline. No law requires that gasoline prices be low or reasonable or just. This means, under both state and federal law, oil companies may charge whatever price the market will bear. In addition,

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Washington has not enacted a "price gouging" statute as have a number of states. Price gouging statutes typically are designed to rein in prices during emergencies, such as natural disasters. Without a price gouging statute, my office has no special authority to investigate high prices, *per se*.

By not regulating gasoline prices, both our Legislature and the Congress have left prices to be set by the interaction of buyers and sellers in a free market rather than by government officials. This is how most, if not all, commodity prices are determined in our economy. Given that fact and in the absence of a price gouging statute, the Attorney General's role in gasoline pricing is limited to protecting the integrity of the marketplace through enforcement of the Consumer Protection Act, including its antitrust provisions. The CPA prohibits:

- unfair or deceptive acts or practices and,
- contracts, combinations and conspiracies in restraint of trade, and
- anti-competitive mergers, monopolistic practices and other exclusionary unilateral practices.

My office and I are ready, willing and able to vigorously enforce these provisions whenever evidence of a violation sufficient to support enforcement exists.

No doubt citizens of Spokane County consider the existing price differential between the Spokane area and other parts of our state to be intrinsically unfair. I share their frustration in that regard. Statutory and case law, however, dictate that in order for an unfair practice to be illegal under the CPA, we must prove three things:

1. The practice offends public policy as set out in statutes, the common law or otherwise.
2. The practice is immoral, unethical, oppressive or unscrupulous.
3. It causes substantial injury to consumers or to competition.

In the long experience of this office in bringing cases under the CPA, proving the first two of these elements based upon price differential alone is problematic, at best. At the very least, it would require a price substantially higher than what we have seen to date or area price differentials several times greater than presently exist. In addition, as some of the attached charts illustrate (*see, e.g.*, the chart on p. 12), Spokane-area prices actually have been lower than Seattle-area prices at various times this year. An unexplained price differential, without more, is likely insufficient to invoke the Attorney General's investigative and subpoena powers under the CPA.

We are presently reviewing the Federal Trade Commission response to Senator Maria Cantwell's inquiry regarding gas prices. As a preliminary matter, several of the Commission's observations are helpful in understanding differences between Spokane and Seattle gas prices. The most

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important difference is that the two markets draw their supply of gasoline from very different sources. Seattle obtains its gasoline from the Puget Sound refineries and seaborne imports.

By contrast, Spokane draws its petroleum supplies from the Rocky Mountain region. Thus, under normal conditions we would expect some differences between prices in the two markets. The FTC graphs are consistent with that observation, demonstrating that while Spokane gas prices are currently higher than Seattle, over time the reverse is often true as well.

Another important conclusion we may draw from the FTC response is that retail margins have remained largely constant. Thus, if any price manipulation is going on, it is not coming from the gasoline retailers, many of them small businessmen and women struggling to survive in a volatile marketplace.

My office has a long history of cooperative relations with the FTC. We will continue to work with that agency to monitor the retail and wholesale petroleum markets. If the FTC or we uncover any evidence of illegal collusion, you may rest assured we will take prompt and aggressive action.

In the absence of evidence of illegal conduct, any examination of price differentials is the province of economists. I would be happy to join you, if you wish, in suggesting to the Legislature that they fund an economic study, either within the Energy Policy Division or by contracting with economists at Washington State University. In addition to supporting such a proposal, we would be glad to work with your office and you to ensure that the study would be objective and scientifically valid.

The Attorney General also has what is known as *parens patriae* authority to enforce federal antitrust laws. Because the substantive provisions of federal antitrust law are so similar to Washington law on the subject, I have not discussed federal law separately.

Collusion among competitors in setting prices violates the antitrust provisions of the CPA. There have been many investigations by state governments and the Federal Trade Commission in the past several years and none has uncovered evidence of collusion. Nevertheless, we take the antitrust laws seriously and would thoroughly investigate any credible allegation of collusion. If you are aware of anyone with knowledge of specific allegations or suspicions that collusion is occurring, please have them immediately contact our Antitrust Division at (206) 587-5510.

In addition to prohibiting collusion among competitors, the antitrust laws also prohibit anti-competitive mergers¹, monopolistic practices and other exclusionary unilateral practices. This office has long played an active role in reviewing petroleum industry mergers and

¹ More information about the Attorney General's merger enforcement activity is available on the Attorney General's web site, <http://www.atg.wa.gov/consumer/gasprices/report.shtml>.

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acquisitions. Most recently, the Antitrust Division reviewed the Conoco Phillips merger in 2002. In that case, the Attorney General required Conoco Phillips to sell its Spokane terminal to an independent party as a condition of approving the merger.

Again, I appreciate the opportunity to address to your concerns. Please feel free to contact me to continue our discussion of these issues, to review any evidence of illegal activity of which you are aware, and to discuss your potential interest in an economic study.

Sincerely,

ROB MCKENNA
Attorney General
RMM:rb

Attachments

cc: Brian Moran, Chief Deputy Attorney General
Nancy Hovis, Deputy Attorney General
Tina Kondo, Antitrust Division Chief
Doug Walsh, Consumer Protection Division Chief
David Huey, Consumer Protection Division